

# ECONOMIC ENVIRONMENT

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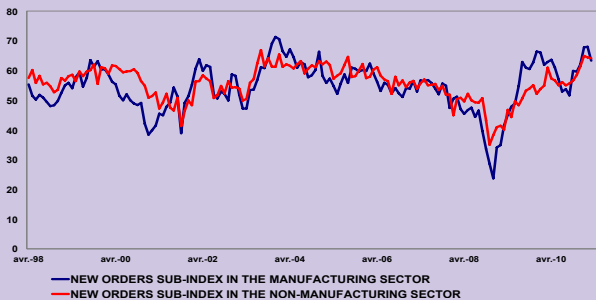


## United States

### SHARP SLOWDOWN IN FINAL DEMAND

Contrary to what was implied by the ISM indices' spectacular rise, growth will have been even weaker in the first quarter of 2011 than in the fourth quarter of 2010. Indeed, all components of final demand are slowing. Trade is penalising growth, because the significant rise in imports is more than offsetting the momentum of exports. Investment in both residential and commercial construction is falling again because of rising mortgage rates. Investment in capital equipment should continue to slow due to the deceleration of profits and substantial overcapacity. Finally, consumption, which rose 0.3% in February, is flattening, and expected to post an annualised increase of less than 2%. Without inventories, growth would be significantly lower in Q1 2011 than in Q4 2010. All these factors confirm our scenario. But the slowdown is expected to intensify in the second quarter under the dual impact inventories, which will once again penalise growth, and, especially, the surge in oil prices. The sharp decline in consumer expectations presages weak consumption, along with a marked drop in purchasing power. Inflation, now at 2.2%, is expected to be near 3% very soon. Leading indicators, like the ISM indices, are falling, and have probably peaked.

### United States: ISM indices reverse course

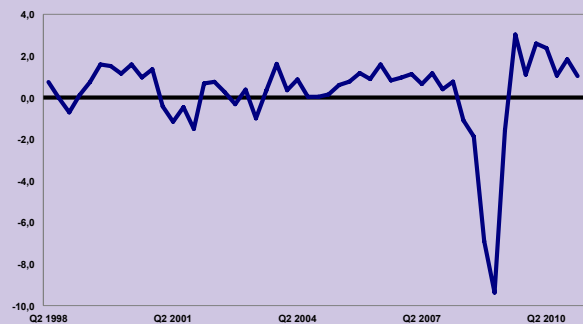


## Euro zone

### GROWTH STAGNATES DUE TO DETERIORATION OF THE PERIPHERAL COUNTRIES

First-quarter growth likely remained at about 0.3%, unchanged from the two preceding quarters. Certainly, business in the construction sector is benefitting from the catch-up effect in France, and even more so in Germany, after the lag accumulated in the previous quarter due to the cold. But despite the momentum in exports, driven by the rebound in world trade on the back of major restocking of intermediate goods, industrial production slowed in the first quarter. Consumption is moderating throughout the eurozone, with the exception of France and Germany. In effect, it is still being penalised by the peripheral countries (Greece, Ireland, Portugal and Spain) where the sovereign debt crisis is worsening: all, except for Spain, have been downgraded several notches by rating agencies. Portugal is about to become a speculative investment for Standard & Poor's and Fitch, as will Ireland for Moody's, whereas Greece already is. Unsurprisingly, Portugal has decided to appeal to the EU for assistance. We expect €50 billion to €60 billion in support, which should be finalised within the next few weeks. Faced with this two-headed eurozone, the ECB decided to raise its key rate, while core inflation fell to 1%, despite the jump in energy prices that has pushed headline inflation to 2.6%.

### Euro zone: slowdown in industrial production (QTRLY CHG, %)



## Japan

### A COLLAPSE IN ACTIVITY

Production and new orders sub-indices of the PMI manufacturing index have each lost 15 points and fallen below 40, pointing to a 10% drop in manufacturing production in the coming months. The drop should have been much steeper: results were biased upward because only 5% of businesses in affected areas responded, resulting in a 65% response rate to the survey instead of the customary 80%. In addition, the PMI reflects the manufacturing sector alone and does not include the energy and power sector where 15% of generating capacity has gone offline or can no longer be operated since the earthquake. Finally, the small business activity and confidence index shows an even more dramatic drop in services and trade – to the levels of the severe recession of 2001 or the financial crisis of 2008. We've factored in a contraction in GDP of 2% in the second quarter. Recovery from reconstruction spending is not likely to happen before the last quarter: to cope with a 20% to 30% shortfall in generation capacity, power outages will affect businesses significantly this summer and will require them to limit their production. Overall, we have factored in a 1% contraction of GDP in 2011, but it could be much higher.

### Japan: small business activity and confidence index (Economy Watcher Survey)

